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Report to the Legislature

MONTANA AGRICULTURAL LOAN AUTHORITY

DEPARTMENT OF AGRICULTURE

Report on the Examination of Financial Statements
Fiscal Year Ended June 30, 1985

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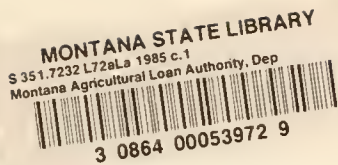
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STATE OF MONTANA

Report to the Legislature

MONTANA AGRICULTURAL LOAN AUTHORITY

DEPARTMENT OF AGRICULTURE

Report on the Examination of Financial Statements
Fiscal Year Ended June 30, 1985

Direct comments/inquiries to:
Office of the Legislative Auditor
Room 135, State Capitol
Helena, Montana 59620
(406) 444-3122

*7/16/85
SC*

FINANCIAL COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Office of the Legislative Auditor to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office.

Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

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Senator Judy Jacobson, Chairman	Representative John Cobb,
Senator Dave Fuller	Vice Chairman
Senator Pat Goodover	Representative Dorothy Bradley
Senator Tom Keating	Representative Roland Kennerly
	Representative Bruce Simon

Audit staff involved in this audit include:

Mary Bryson, CPA; Vickie Rauser, CPA; Suzanne Wellcome, CPA

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122



SCOTT A. SEACAT
LEGISLATIVE AUDITOR

DEPUTY LEGISLATIVE AUDITORS:

JAMES GILLET
FINANCIAL-COMPLIANCE AUDITS

JIM PELLEGRINI
PERFORMANCE AUDITS

LEGAL COUNSEL:

JOHN W. NORTHEY

December 1985

The Legislative Audit Committee
of the Montana State Legislature:

This document is the result of our audit of the Montana Agricultural Loan Authority of the Department of Agriculture. The authority's written response to the report is included in the back of the audit report. We would like to thank the administrator, his staff, and the authority personnel for their cooperation and assistance during the audit.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Scott A. Seacat", written over a horizontal line.

Scott A. Seacat
Legislative Auditor



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APPOINTIVE AND ADMINISTRATIVE OFFICIALS

MONTANA AGRICULTURAL LOAN AUTHORITY

		<u>Term Expires</u>
Paul Ringling, Chairman	Miles City	January 1, 1987
Dennis DeVries	Polson	January 1, 1987
Dave Gorton	Billings	January 1, 1987
Terry Murphy	Great Falls	January 1, 1987
Dixie Halvorson	Scobey	January 2, 1989
Bernard Harkness	Dell	January 2, 1989
Keith Kelly	Helena	January 2, 1989
Dennis Robinson	Lewistown	January 2, 1989
Harry Rodenburg	Wolf Point	January 2, 1989

AUTHORITY STAFF

Michael Murphy, Administrator

Jeanette DeWolf, Secretary

SUMMARY OF RECOMMENDATIONS

This listing serves as a means of summarizing the recommendations contained in the report and the audited agency's reply.

Page

Recommendation #1

The department record all activity related to bond issues on its financial records.

4

Agency Response: Do not concur. See page 17.

Recommendation #2

The department seek a budget amendment for the appropriation authority necessary to ensure expenses of the program are properly charged to the program.

5

Agency Response: Partially concur. See page 18.

INTRODUCTION

We performed a financial-compliance audit of the Montana Agricultural Loan Authority (the authority) for the fiscal year ended June 30, 1985. The objectives of the audit were to: 1) determine if the authority's financial statements present fairly the financial position for the fiscal year ended June 30, 1985, and the results of operations for the year then ended; 2) determine the authority's compliance with applicable laws and regulations; and 3) make recommendations for improvement in the Department of Agriculture's management and internal controls.

The report contains two recommendations to the department. These recommendations address areas where management and compliance with regulations can be improved. Other areas of concern deemed not to have a significant effect on the successful operations of the authority are not specifically included in the report, but have been discussed with management. The prior audit of the authority for the fiscal year ended June 30, 1984, contained no recommendations.

In accordance with section 5-13-307, MCA, we analyzed the cost of implementing the recommendations made in this report. The cost of implementation, if significant, is disclosed within each report section.

We reviewed compliance with state laws and regulations that could have a material impact on the financial statements of the authority. In our opinion, the authority complied with state laws and regulations tested. Nothing came to our attention that caused us to believe that untested transactions are not in accordance with applicable laws and regulations.

We thank the administrator, his staff, and Department of Agriculture personnel for their cooperation and assistance during the audit.

BACKGROUND

The Montana Agricultural Loan Authority was established by Chapter 580, Laws of 1983. Chapter 448, Laws of 1985, established

the loan guarantee program whereby the authority may guarantee and make commitments to guarantee payments required by authority funded loans. The authority is attached to the Department of Agriculture for administrative purposes. Financial accounting for the authority is performed by the department's Centralized Services Division. The authority is responsible for administering the following two programs.

The Beginning Farm Loan Program is a tax-exempt bond program designed to assist beginning Montana farmers and ranchers purchase agricultural land, agricultural improvements, and depreciable agricultural property. Applications for the loans are approved by the authority and a participating financial institution (the lender). Non-recourse bonds issued by the authority are purchased by the lender and the bond proceeds are used to finance the loan. This loan is collateral for the tax-exempt bond. The tax free interest on the bonds enables the lender to offer a lower interest rate to the farmer. Terms of each bond are set to reflect exactly the terms of each respective loan. During fiscal year 1984-85, the authority approved five loans. Two loans were granted and the authority issued bonds totaling \$193,800. Bond terms provide that neither the state nor the authority assumes obligation for their repayment.

The Tax Deduction on Sale of Agricultural Land Program provides for a state tax deduction to the seller of agricultural land if the sale is made to a qualified beginning farmer. The sale transaction must be approved by the authority. The seller makes application to the authority for the tax deduction within one year of the closing of the sale. As of June 30, 1985, no applications for tax deduction have been received.

Section 80-12-401, MCA, requires an annual audit of the financial activity of the authority. This is the second audit of the authority. During the initial year of operations the authority received no applications for loans. Therefore, no revenues were generated and the authority sustained an operating loss for the fiscal year ended June 30, 1984.

The authority also sustained an operating loss in fiscal year 1984-85. We considered additional factors that raised questions related to the authority's operations. Department personnel indicated that between \$3 and \$4 million in loans must be issued each year to support the program. At this time, only one loan application is pending and no new applications have been received. According to department officials, the current economic situation in agriculture has hindered the development of the program. Federal restrictions on beginning farmer eligibility further limit potential applicants. Pending federal legislation would remove some limitations, but passage is uncertain. Evaluation of these factors raises questions about the continued viability of the Montana Agricultural Loan Authority as it is presently structured.

BONDS ISSUED, LOANS GRANTED

When a loan to a beginning farmer is approved by a lending institution and the authority, the authority issues bonds that are purchased by the lender. The authority uses the bond proceeds to purchase the bank's note that is then assigned as collateral for repayment of the bonds. During 1984-85, the authority issued \$193,800 of bonds and purchased \$193,800 of notes. The department did not record these transactions on its financial records. The department also did not record any interest revenue or expense related to the bond issues.

Generally accepted accounting principles require that all assets and liabilities of an entity be recorded on the financial records and reported on its financial statements. Section 80-12-301(2), MCA, states, "Each issue of its bonds is an obligation of the authority, payable out of any revenues, assets, or money generated by the Montana agricultural loan authority program." The authority has chosen to further restrict its obligation in that the bonds are guaranteed only by the proceeds of the related loans. Section 80-12-302(2), MCA, states, in part, "A resolution or trust indenture . . . may contain provisions . . . pledging all or any part of the assets of the authority. . . ."

The bonds are issued by the authority and are thus an obligation of the authority. The loans are made by the authority to the individual farmers and thus are receivables of the authority. Assignment of the loans by the authority to the lending institution which purchased the bond does not change the fact that the authority is financially involved.

The financial statements are to reflect the financial activity of the authority and the bond activity should be reported. The result of these omissions is to understate assets and liabilities of the authority by \$193,800, and to understate revenues and expenses by \$2,930.

RECOMMENDATION #1

WE RECOMMEND THE DEPARTMENT RECORD ALL ACTIVITY RELATED TO BOND ISSUES ON ITS FINANCIAL RECORDS.

EXPENSES

The authority's financial activities are recorded in an Enterprise Fund as required by section 80-12-311, MCA. This fund accounts for operations financed and operated in a manner similar to private business enterprises. It is the intent of the Legislature that the program be self-supporting. Because the Beginning Farm Loan Program has been operating on a General Fund loan and there was initial uncertainty about its actual success, management decided to minimize costs charged until such time as bond sales can offset program costs. Appropriation authority imposed further limits on the amounts and types of expenses that were charged to the program. However, identification of all costs associated with the program will assist in management's assessment of the future direction of the authority and will allow a determination as to when total program costs are offset. Accordingly, only those expenses that relate to the operation of the authority should be recorded on the authority's financial statements. The following paragraphs describe expenses that were not properly recorded.

Payroll Charges and Other Expenses

The salaries of the authority's administrator and secretary were charged 100 percent to the program. Each of them, however, worked approximately one-third of their time on program activities. Generally accepted accounting principles and the need for complete management information require that only those expenses incurred are rightfully reported in an Enterprise Fund. This improper recording resulted in the overstatement of expenses by \$34,778. Department officials indicated that the personal services appropriation for the authority was for two FTEs. They charged the expense where appropriation authority existed. For fiscal year 1985-86, the department has appropriation authority to charge one-third of the secretarial costs to the authority.

The Centralized Services Division at the Department of Agriculture performs payroll and word processing services for the authority. Indirect charges, based on a percent of personal services costs, were incurred but not recorded. The authority uses equipment including desks, file cabinets, and a typewriter which belong to other department programs. They paid no rent on this equipment. Rent is an expense of the program and should be so recorded. These omissions resulted in an understatement of expenses of \$3,167.

RECOMMENDATION #2

WE RECOMMEND THE DEPARTMENT SEEK A BUDGET AMENDMENT FOR THE APPROPRIATION AUTHORITY NECESSARY TO ENSURE EXPENSES ARE PROPERLY CHARGED TO THE PROGRAM.

INTERNAL CONTROL

We have examined the financial statements of the Montana Agricultural Loan Authority for the fiscal year ended June 30, 1985. We issued our opinion dated November 8, 1985, on these statements. As part of our examination, we made a study and

evaluation of the system of control of the Montana Agricultural Loan Authority which is administered through the Department of Agriculture. Our study evaluated the system as required by generally accepted auditing standards for financial compliance audits. We classified the controls in the following categories: 1) revenue, 2) payroll, and 3) expenses.

Our study included the control categories listed. Through our study, we determined the nature, timing, and extent of our audit procedures. We did not study or evaluate controls over cash or loans. We applied alternative audit tests to cash to determine the extent of the department's compliance with state accounting policies, and tested 100 percent of the transactions related to loans. We performed substantive audit tests on revenue, payroll, and expenses because it was more efficient to do so. We did not evaluate the control system to the extent necessary to give an opinion on either individual segments or the system as a whole.

The management of the Montana Agricultural Loan Authority is responsible for establishing and maintaining a system of accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable assurance that: 1) assets are safeguarded against loss from unauthorized use or disposition; 2) transactions are executed in accordance with management's authorization; and 3) transactions are recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Inherent limitations in any system of controls may cause errors or irregularities to remain undetected. The current system study should not be used to project to future periods since the procedures may become inadequate or compliance with them may deteriorate.

The limited purpose of our study described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the

system of controls used by the Montana Agricultural Loan Authority. Our study disclosed no condition that we believe to be a material weakness in internal control.

The preceding four paragraphs are intended solely for the use of management and the Legislature and should not be used for any other purpose. This restriction as to use is not intended to limit the distribution of this document which, upon presentation to the Legislative Audit Committee, is a matter of public record.

AUDITOR'S OPINION LETTER
AND AUTHORITY FINANCIAL STATEMENTS

SUMMARY OF AUDIT OPINION

The auditor's opinion issued in this report is intended to convey to the reader of the financial statements the degree of reliance which can be placed on the amounts presented. We issued an adverse opinion on the financial statements of the Montana Agricultural Loan Authority. The reader should not place reliance on the amounts presented in these financial statements.

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122



SCOTT A. SEACAT
LEGISLATIVE AUDITOR

DEPUTY LEGISLATIVE AUDITORS:

JAMES GILLET
FINANCIAL COMPLIANCE AUDITS

JIM PELLEGRINI
PERFORMANCE AUDITS

LEGAL COUNSEL:

JOHN W. NORTHEY

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the Balance Sheet as of June 30, 1985, and the related Statement of Revenues, Expenses, and Changes in Retained Earnings and the Statement of Changes in Financial Position of the Montana Agricultural Loan Authority for the fiscal year then ended. Our examination was made in accordance with generally accepted auditing standards and Standards for Audits of Governmental Organizations, Programs, Activities, and Functions and, accordingly, included such tests of the accounting records and other such audit procedures as we deemed necessary in the circumstances.

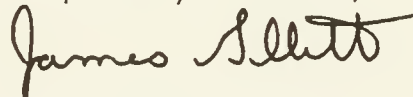
The authority issued \$193,800 of bonds to lending institutions. With bond proceeds, it purchased the notes issued by the lenders to the beginning farmers. Neither the bonds payable, the notes receivable, nor related interest revenues and expenses are reported on the authority's financial statements. These assets and liabilities should be reported in order to conform with generally accepted accounting principles. The details of the transactions are summarized in Note 4.

Costs incurred on behalf of the authority are not properly stated. Individuals working only one-third time for the authority are charged to the authority for full-time. Indirect costs incurred by the program are not charged. The net effect of improper recording of costs is that expenses are overstated by \$30,032.

As shown in the financial statements, the authority incurred a net loss of \$73,006 during the fiscal year ended June 30, 1985, and as of that date, the authority's current assets exceeded its current liabilities by \$9,928 but total liabilities exceeded total assets by \$126,546. These factors, as discussed in Note 6, indicate the authority may be unable to continue in existence. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the authority be unable to continue in existence.

In our opinion, because of the effects of not recording the transactions related to the bonds issued and loans granted as described in paragraph two and the improperly recorded expenses as noted in paragraph three, and subject to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty about the recoverability and classification of recorded asset amounts and the amounts and classification of liabilities referred to in the preceding paragraph been known, the financial statements referred to above do not present fairly, in accordance with generally accepted accounting principles, the financial position of the Montana Agricultural Loan Authority Enterprise Fund as of June 30, 1985, or the results of its operations and the changes in its retained earnings for the year then ended.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "James Gillett", written in a cursive style.

James Gillett, CPA
Deputy Legislative Auditor

November 8, 1985

MONTANA AGRICULTURAL LOAN AUTHORITY
DEPARTMENT OF AGRICULTURE
BALANCE SHEET - ENTERPRISE FUND
JUNE 30, 1985

Assets	
Cash	\$ 22,006
Accounts Receivable	86
Equipment	<u>1,495</u>
Total Assets	<u>\$ 23,587</u>
Liabilities	
Inter-entity Loan Payable	\$ 137,969
Accounts Payable	<u>12,164</u>
Total Liabilities	<u>150,133</u>
Fund Equity	
Retained Earnings	<u>(126,546)</u>
Total Fund Equity	<u>(126,546)</u>
Total Liabilities and Fund Equity	<u>\$ 23,587</u>

The notes to the financial statements are an integral part of this statement.

MONTANA AGRICULTURAL LOAN AUTHORITY
DEPARTMENT OF AGRICULTURE
STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN RETAINED EARNINGS
ENTERPRISE FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 1985

Operating Revenue:	
Application Fees	\$ 500
Origination Fees	3,600
Total Operating Revenue	<u>4,100</u>
Operating Expenses:	
Personal Services	53,015
Contracted Services	16,485
Supplies and Materials	377
Communications	2,686
Travel	4,055
Rent	1,033
Repair and Maintenance	685
Other Expenses	127
Equipment and	
Intangible Assets	138
Total Operating Expenses	<u>78,601</u>
Net Income (Loss)	<u>(74,501)</u>
Retained Earnings, July 1, 1984	(53,545)
Prior Period Adjustment	<u>1,500</u>
Retained Earnings, Restated	<u>(52,045)</u>
Retained Earning, June 30, 1985	<u><u>\$(126,546)</u></u>

The notes to the financial statements are an integral part of this statement.

MONTANA AGRICULTURAL LOAN AUTHORITY
DEPARTMENT OF AGRICULTURE
STATEMENT OF CHANGES IN FINANCIAL POSITION
ENTERPRISE FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 1985

Sources of Working Capital:

Operations:	
Net Income (loss)	\$ (74,501)
Items not Requiring Working Capital:	
Prior Period Adjustment	<u>1,500</u>
Working Capital Provided by Operations	(73,001)
Uses of Working Capital	<u>-0-</u>
Net Increase (Decrease) in Working Capital	<u><u>\$ (73,001)</u></u>

Elements of Net Increase (Decrease)
in Working Capital:

Cash and Cash Equivalent	\$ (27,311)
Receivables	86
Accrued Expenses	2,990
Accounts Payable	(8,766)
Inter-entity Loan Payable	<u>(40,000)</u>
Net Increase (Decrease) in Working Capital	<u><u>\$ (73,001)</u></u>

The notes to the financial statements are an integral part of this statement.

MONTANA AGRICULTURAL LOAN AUTHORITY
DEPARTMENT OF AGRICULTURE
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDING JUNE 30, 1985

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Montana Agricultural Loan Authority is responsible for administering the activities of the Beginning Farm Loan Program and the Tax Deduction on Sale of Agricultural Land Program. These programs are designed to help private lenders assist beginning farmers and ranchers to acquire agricultural property.

A. Basis of Accounting

The financial statements were prepared from the Statewide Budgeting and Accounting System with adjustments.

The authority utilizes the accrual basis of accounting for the Enterprise Fund. Under this basis, revenues are recognized in the accounting period in which they are earned and become measurable. Expenses are recognized in the period incurred, if measurable.

B. Description of Fund

The fund presented and its relationship to the State Treasury Fund structure is as follows:

PROPRIETARY FUND TYPE

Enterprise Fund - To account for operations: (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the Legislature is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

C. Encumbrances

Encumbrances are recorded for purchase orders, contracts, and other commitments in order to reserve that portion of applicable appropriations for all funds. At fiscal year-end, in accordance with state policy, major qualifying encumbrances are reclassified as payables and charged as expenditures.

D. Inventories

Inventories consist of expendable supplies held for consumption. The cost is recorded as an expenditure at the time individual inventory items are purchased. The amount of supplies inventory on hand at June 30, 1985, was immaterial.

E. Insurance

The authority is insured through the Insurance Division of the Department of Administration.

2. EMPLOYEES' RETIREMENT SYSTEM

The authority's employees are covered by the Public Employees' Retirement System (PERS). This plan is administered by the state of Montana. Under PERS, the state contributes 6.417 percent of an employee's gross wages to PERS. All eligible employees contribute 6.0 percent of gross wages. The authority's contribution to PERS for the fiscal year ended June 30, 1985, was \$2,791.

The state's policy is to fund accrued pension costs. The unfunded past service costs and the actuarially computed value of the vested benefits are not readily available for the members of the plan employed by the authority. The Public Employees' Retirement System was actuarially sound at June 30, 1984.

3. ANNUAL AND SICK LEAVE

Annual leave and sick leave costs are not recorded until leave is taken. Upon termination, qualifying employees with unused accumulated annual leave and sick leave receive 100 percent

payment for annual leave and 25 percent payment for sick leave. The liability amount associated with unused annual leave and sick leave at June 30, 1985, is maintained on an hourly basis. Annual leave is earned based on length of state service (15 days per year, up to 24 days per year). Payouts of leave are made at current payroll rates. As of June 30, 1985, the authority had a predicted liability of \$6,701 for vacation leave and sick leave.

4. LONG-TERM NOTES RECEIVABLE, BONDS PAYABLE

The authority issued two bonds during fiscal year 1985 totaling \$193,800. The bond proceeds were used to purchase the notes from the lending institution. These notes were then assigned to the lender as collateral for the bonds. The terms of the note and related bond are identical. Interest rates are variable on an annual basis.

Long-term debt and the related long-term notes receivable consist of the following as of June 30, 1985:

Bond Amount \$81,600

8.75 percent bond payable. Note receivable in 20 annual installments of \$8,781 (including principal and interest). Payments are due beginning May 3, 1986.

Bond Amount \$112,200

9.3 percent bond payable. Note receivable in 9 annual installments of \$17,719 (including principal and interest) beginning May 3, 1986.

The amount of interest revenue and expense related to the bonds issued is \$2,930 for the fiscal year ended June 30, 1985.

5. INTER-ENTITY LOAN

House Bill 447, Laws of 1983, gave authority for a General Fund loan of \$97,969 for fiscal year 1983-84 and \$99,325 for fiscal year 1984-85. House Bill 500, Laws of 1985, extended the repayment of the loan to June 30, 1987. The balance of the loan at June 30, 1985, was \$137,969.

6. GOING CONCERN

The authority sustained an operating loss in fiscal year 1984-85 of \$73,006. Consideration of additional factors raises the question of the continued existence of the authority.

1. Only two loans, totaling \$193,800, were granted during fiscal year 1984-85. It is believed that between \$3 and \$4 million in loans must be granted each year in order for the program to be self-supporting. One loan application for \$250,000 is pending, but no new applications have been received.
2. House Bill 500, 1985, extended the General Fund loan repayment date to June 30, 1987, but the loan will not be paid in full by that time.
3. Current economic factors in agriculture have contributed to the lack of development of the program. Federal legislation is pending that would facilitate that development, but the outcome of such legislation is uncertain.
4. During the first year of MALA, federal legislation related to the tax-exempt status of the bonds was pending. The authority's bond counsel would not offer a clean opinion on the authority's bonds until the issue was resolved, and thus program activity during the first year was halted.
5. The 49th Legislature of Montana enacted legislation allowing the state to guarantee agricultural loans, but no spending authority was provided.

AGENCY RESPONSE



STATE OF MONTANA
DEPARTMENT OF AGRICULTURE

TELEPHONE
AREA CODE 406
444 3144

TED SCHWINDEN
GOVERNOR

OFFICE OF THE DIRECTOR
AGRICULTURE/LIVESTOCK BLDG.
CAPITOL STATION
HELENA, MONTANA 59620-0201

KEITH KELLY
DIRECTOR

January 6, 1986

Mr. Scott A. Seacat
Legislative Auditor
Office of the Legislative Auditor
State Capitol
Helena, MT 59620

Dear Mr. Seacat:

The following responses to the audit of the Montana Agricultural Loan Authority (MALA) are presented by me on behalf of the MALA and the Montana Department of Agriculture. The audit report contains two (2) recommendations. I am responding separately to each recommendation as follows:

"Recommendation #1 We recommend the department record all activity related to bond issues on its financial records."

Recommendation #1 -- Response

Section 80-12-301(3), MCA, authorizes the MALA to issue bonds at both private and public sale. The department does not agree that bonds issued to private purchasers (financial institutions) are debts/liabilities of the MALA/departments/state. Section 80-12-301(2), MCA, is appropriately interpreted with respect to bonds issued at public sale. Bonds issued for public sale would be secured by the corresponding loans purchased and held by the MALA. However, the liability for bonds sold at private sale to financial institutions are by agreement (bond resolution, etc.) assigned to the purchaser. MALA retains no financial liability nor does it pledge any additional assets to ensure repayment of the bond. The bond is backed solely by the repayment of the loan (the asset) which is assigned to the bond holder. Considering these points, it is not appropriate that the department maintain records of principal and interest payments on loans as reported revenue and corresponding liability. Loan payments to the financial institutions are not viewed as revenue to the MALA. The financial institutions assume financial liability associated with the bond as well as responsibility for protecting their interests by properly servicing the corresponding loan. The MALA does require the financial institution to provide an annual summary regarding loan performance and interest rate fluctuations. Assuming responsibility for the loan servicing

Mr. Scott A. Seacat
Page 2
January 6, 1986

procedures or revenues and corresponding liability may, in fact, establish grounds for legal action against the MALA/department/state for financial liability where none is assumed by statute or by legal contract (bond resolution/loan agreement, etc.). Responsibility for loan servicing/monitoring functions would also add significantly to program costs and be contrary to legislative intent to administer the program as simply and economically as possible.

With regards to audit report wording related to recording all expenses associated with bond issuance, the department does in fact, record all expenses related to the bond issuance. The wording of this section might be more appropriately directed at the bond payment liability issue.

The department and the MALA do agree that Section 80-12-301(2), MCA, should be reviewed for consideration for change to clarify legislative intent and the distinction between private and public bond sale. The department also suggests that an opinion of the Office of the Attorney General may be necessary to determine statutory intent.

"Recommendation #2 We recommend the department seek a budget amendment for the appropriation authority necessary to ensure expenses are properly charged to the program."

Recommendation #2 -- Response

The department and the MALA agree that the appropriate percentage of personal services for the division administrator and secretary be appropriated to the other programs within the Agricultural Development Division. However, legislative appropriation for these positions was provided entirely from MALA program appropriation. As noted in the audit report, the department already took the necessary steps for legislative appropriation of the secretarial position from other division programs so that only one-third (1/3) of that position is now funded by the MALA program. (See HB 500).

The department does not agree that two thirds (2/3) of the administrator position be funded through other division programs. The administrator has previously allocated time to other division activities as a result of the existing agricultural conditions and needs of the industry. However, the position is responsible for MALA program operations. Therefore, as industry and program requirements change the position will allocate at least two-thirds (2/3) of the time to the MALA related program. The

Mr. Scott A. Seacat
Page 3
January 6, 1986

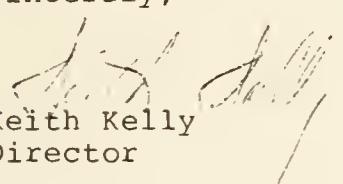
department does agree that one-third (1/3) of respective personal services could be funded by other division programs. However, it is not possible to request a general fund budget amendment to facilitate the change. Such a related appropriation request will be presented to the Appropriation Committee during the 1987 legislative session.

In regards to the issue of allocating rent against the MALA program for office furniture and equipment, it is a sound management decision to not expense such costs to the program which is operating on a general fund loan. The decision is also based upon the fact that the program is able to operate utilizing used furnishings and equipment borrowed from other programs until such time as it is financially wise to make equipment purchases.

In reponse to the issue of expensing indirect cost to the program, such costs are not being recorded to the MALA program consistent with legislative appropriation and that it is a sound management decision to not expense such costs to the program which is operating on a general fund loan for Fiscal Year 86.

I would like to thank you and your staff for the courteous and professional manner in which this audit was conducted.

Sincerely,



Keith Kelly
Director

MM/pb

